

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF WEST MCCRACKEN COUNTY)	
WATER DISTRICT FOR (1) GENERAL RATE)	
INCREASE, (2) REVISION OF TARIFFS, (3))	CASE NO. 94-450
APPROVAL OF SURCHARGE, AND (4) REQUEST)	
FOR APPROVAL OF VARIANCE ON FINANCIAL)	
DATA)	

O R D E R

On November 21, 1994, West McCracken County Water District ("West McCracken") applied to the Commission for a general rate increase, a revision of its tariffs, approval of a surcharge, and approval of a variance on financial data. The application was considered filed on December 22, 1994, when all deficiencies were cured. The proposed rates would generate additional annual revenues of \$112,000. The tariff revision would make numerous major and minor changes in West McCracken's Rules, Rates and Regulations. The surcharge would provide West McCracken with funds to construct improvements and extensions from an established priority list. The variance on financial data would allow West McCracken to submit a 1993 calendar year audit and 1994 monthly financial statements.

On January 12-13, 1995, Commission Staff ("Staff") performed a limited financial review of West McCracken's operations and prepared a cost-of-service study for the test year, calendar year 1993. Based upon this review, Staff issued a Report on April 17, 1995, recommending that West McCracken be allowed to increase its annual operating revenues from water sales by \$96,303. The rates

were based on the cost-of-service study, and altered the rates requested by West McCracken. The Staff Report further recommended approval of the proposed surcharge, \$0.47 per 1,000 gallons of water sold, to be used for the projects specified in West McCracken's priority list. The Staff Report recommended that the tariff modifications, with the exception of those related to water line extensions, be approved.

An informal conference was held on May 10, 1995 at the request of West McCracken.

On May 31, 1995, West McCracken filed its response to the Staff Report in which it revised certain requests contained in the application and argued against several recommendations contained in the Staff Report. This Order addresses these areas of concern, including Revenue Requirements Determination, Surcharge, Rate Design, and Tariff Revisions Regarding Water Line Extension. All other findings of the Staff Report are adopted by the Commission as its own.

REVENUE REQUIREMENTS DETERMINATION

The Staff Report recommended that West McCracken's revenue requirement be determined based in part on an annual debt service of \$43,040 resulting in a required revenue increase of \$96,303. West McCracken contends that the recommended amount would not be sufficient to make the annual payments and to retire the principal amount in arrears, approximately \$68,000, by the year 2007. In its application, West McCracken proposed a \$6,500 increase in the annual debt service to eliminate the arrearage. This amount was

inadvertently omitted from Staff's calculations because it appeared to have been included in the amortization schedule provided.

Provision should be made for West McCracken to retire its arrearage as a water district has no means of paying its debt except through rates. The Commission has calculated the additional annual payment required to be \$6,864 and has determined West McCracken's required revenue increase to be \$104,540, calculated as follows:

Adjusted Operating Expenses	\$ 368,286
Average Annual Debt Service	49,904
20 Percent DSC	<u>9,981</u>
Total Revenue Requirement	\$ 428,171
Less: Normalized Operating Revenues	309,099
Other Operating Revenues	13,907
Interest Income	<u>625</u>
Required Revenue Increase	<u>\$ 104,540</u>

SURCHARGE

In its application, West McCracken proposed a surcharge, pursuant to KRS 74.395, of \$0.47 per 1,000 gallons of water sold, the proceeds of which would be used to finance various construction projects. Staff recommended approval of the surcharge and stated that the surcharge funds should be used for the projects specified by West McCracken in Exhibit 2 of its Application. In its Response, West McCracken sought to amend this list because of recent requests from potential customers. It provided a new priority list of construction projects:

1. Cunningham and Palestine School Roads	\$145,000
2. Woodville Road (east)	40,000
3. Replacement of old lines	100,000

4.	PRV's, pump and chlorinator	50,000
5.	Kelly, Magruder & Woodville Roads	200,000
6.	Hinkleville and West Airport Roads	150,000
7.	U.S. 60 and Steele Road	200,000
8.	L. Harris, McKendree Church, and Highway 286	650,000

The Commission finds that the projects contained in the amended priority list are appropriate for the use of surcharge revenues. A Certificate of Public Convenience and Necessity will be necessary prior to beginning construction on any of the proposed projects.

RATE DESIGN

Rates in the Staff Report were based on the cost-of-service study. West McCracken strongly disagreed with these rates, stating that the minimum rate would place an unjust burden on average and low volume residential customers and that the customer charges were not fairly distributed among the customer classes. Under West McCracken's proposal, a customer who uses 1,000 gallons would receive a decrease of 5.3 percent while the same customer would receive an increase of 57.3 percent under the proposed cost-of-service method.

In its application, West McCracken proposed to change its rate design from declining block rates to a customer charge and a two step rate design. The two step rate design was designed to give a lower rate to large volume users. The Staff Report recommended accepting the change. However, after preparing a cost-of-service study, Staff determined that the proposed customer charge for a 5/8 inch connection did not cover the cost of providing service. Staff therefore recommended revising the charge of \$4.00 per month to a

charge of \$9.57 per month, using the methodology set out in the AWWA M-1 Manual. The charges include costs for maintenance of meters, hydrants and services, meter reading, and certain administrative expenses.

West McCracken opposed the increased charge as failing to consider either the additional expense of testing a larger meter or the added depreciation. However, West McCracken did not disclose how it determined its proposed customer charges.

West McCracken's proposed rates are based on the premise that all expenses should be allocated using the percentage of water used. West McCracken argues, in other words, that if a customer uses 20 percent of the water, the customer should pay 20 percent of the expenses. This simplistic methodology may be used to design rates if all customers use approximately the same amount of water. However, West McCracken's largest user purchases an average of 1,250,000 gallons per month. The AWWA M-1 Manual states that certain costs, such as meter reading and billing and collecting, are fixed and do not vary with the amount of water used. For example, a customer who uses 20 percent of the water produced should not be required to pay 20 percent of all postage expense.

West McCracken is concerned that the cost-of-service rates cause an increase in excess of 100 percent for customers who use from 1,001 to 2,000 gallons. In light of West McCracken's concern, the Commission has determined that the cost-of-service study should not be fully implemented at this time. The rates, set forth in Appendix A, will reduce the impact on the smaller user, are fair,

just, and reasonable, and should be adopted. These rates also recognize the additional debt service expenses discussed above.

TARIFF REVISIONS REGARDING WATER LINE EXTENSIONS

West McCracken proposed three tariff modifications related to water line extensions: [1] elimination of subdivision developer "paybacks"; [2] development of its own priority list for extensions and improvements to the system (rather than continuing to accommodate, at the cost of fifty feet of line per customer, those who request water extensions which are not on the utility's "priority" list); and [3] increased tap-on fees in subdivisions where there is an existing payback plan with a developer. The Staff Report recommended denial of all three proposals because they do not conform to Commission regulations. West McCracken subsequently withdrew its request to charge customers on main extensions an additional \$1,000 but continues to seek approval of the other requested revisions. The Commission finds that all three requests should be denied for the reasons set forth in the discussion below.

West McCracken proposes to eliminate the 50 feet payback to subdivision developers for new customer connections, arguing that such refunds can bankrupt rapidly growing utilities. West McCracken calculates that it takes 13 years to recover the developer payback. It further argues that the payback enables the developer twice to recover the cost of the extension: first when he sells the lot to the customer, then again when he gets the refund from the utility.

807 KAR 5:066, Section 11(3), contains the Commission's standard water line extension policy regarding subdivisions:

An applicant desiring an extension to a proposed real estate subdivision may be required to pay the entire cost of the extension. Each year, for a refund period of not less than 10 years, the utility shall refund to the applicant who paid for the extension a sum equal to the cost of 50 feet of the extension installed for each new customer connected during the year whose service line is directly connected to the extension installed by the developer, and not to extensions or laterals therefrom. Total amount refunded shall not exceed the amount paid to the utility. No refund shall be made after the refund period ends.

[Emphasis added.]

807 KAR 5:066, Section 11(4), provides for exceptions from the rule:

Nothing contained herein shall be construed to prohibit the utility from making extensions under different arrangements if such arrangements have received the prior approval of the commission.

While the developer may indeed twice recover his cost for the extension, as West McCracken argues, it is not within the jurisdiction of the Commission to determine the developer's profits. Nor did West McCracken file persuasive evidence that the standard refund policy could actually bankrupt the utility. It may create short-term cash flow problems, but the long-term revenue benefits provided by the additional customers should provide a sufficient offset.

West McCracken also proposes to revise its present extension policy which provides that, when an individual or group wishes to have a water line extended, West McCracken pays for 50 feet of the extension per new customer while the customers pay the remainder.

As customers connect to the line for the next ten years, the District issues refunds to the original investors.

807 KAR 5:066, Section 11(1), states as follows:

An extension of fifty (50) feet or less shall be made by a utility to its existing distribution main without charge for a prospective customer who shall apply for and contract to use service for one (1) year or more.

807 KAR 5:066, Section 11(2)(a), states that, if applicants' request for a new extension exceeds 50 feet per applicant, the applicants may be required to pay for the excess cost. Finally, 807 KAR 5:066, Section 11(2)(b), provides that, when customers have paid for more than 50 feet of line, those customers "shall" be reimbursed as other customers connect to that extension.

While West McCracken's current policy conforms to the regulations, its proposed policy would not. West McCracken seeks permission to maintain a priority list for extensions and improvements based on a number of criteria, such as the presence of health hazards, the quality and quantity of water available, the increased reliability of the system, the encouragement of growth, and cost versus benefit. When money is available, the first extension on the priority list would be constructed, with West McCracken paying the entire cost of construction. Those individuals requesting an extension which is not on the priority list would have to pay for the entire cost of the extension plus a tapping fee. Anyone who tapped onto such an extension later would be required to show that he had reimbursed prior investors his pro-rata share of the original construction cost.

West McCracken's third proposal concerns subdivisions where there is an existing payback contract with a developer. For new customer taps in these subdivisions, West McCracken seeks permission to charge its normal tapping fee plus the amount of the developer payback for that particular subdivision.

Here again, the addition of the new customers, with the resulting increase in revenues for West McCracken, should in time more than offset the developer payback. West McCracken argues that the Commission "has already approved an additional tap-on fee to cover developer payback," citing its tariff at section 21 D (5) (a). This interpretation of the tariff section is misleading. The section in question does, "under certain circumstances," provide for such an additional fee. However, the fee will be assessed only if it is "approved by the Commonwealth of Kentucky, Public Service Commission." Thus, the tariff only provides for the possibility of special arrangements on a case-by-case basis. Special arrangements in the public interest do not violate the regulations and are, in fact, covered by them. The cited portion of the tariff bears no relation to the blanket deviation West McCracken now requests. While this request should be denied as well, special arrangements may be requested on a case-by-case basis.

The Commission, having reviewed the evidence of record and being otherwise sufficiently advised, finds that:

1. The recommendations and findings contained in the Staff Report, except where specifically changed in this Order, are supported by the evidence of record, are reasonable, are hereby

adopted as the findings of the Commission in this proceeding, and are incorporated by reference as if fully set out herein.

2. The rates proposed by West McCracken should be denied.

3. The rates set forth in Appendix A, are the fair, just, and reasonable rates for West McCracken, will produce gross annual revenues from water sales of \$413,639 and will allow West McCracken sufficient revenues to meet its operating expenses and service its debt.

4. The surcharge set out in Appendix A is reasonable and adequate to implement the proposed projects.

IT IS THEREFORE ORDERED that:

1. The recommendations and findings contained in the Staff Report, except where specifically changed in this Order, are adopted as the findings of the Commission and are incorporated by reference as if fully set out herein.

2. The rates proposed by West McCracken are hereby denied.

3. The rates contained in Appendix A are approved for service rendered by West McCracken on and after the date of this Order.

4. The surcharge set out in Appendix A is approved for service rendered by West McCracken on and after the date of this Order, for a period not to exceed 5 years.

5. All funds generated by the surcharge shall be deposited in a separate reserve trust account. These funds shall be invested in securities issued or guaranteed by the United States Government until they are needed, and shall be expended, together with any

interest or other earnings thereon, solely for the purpose of financing the projects specified in this Order.

6. West McCracken shall obtain approval from the Commission prior to performing any additional construction, including those projects specified in this Order to be financed through surcharge revenues.

7. No deviation from the approved use of surcharge revenues may be undertaken without the prior approval of the Commission.

8. West McCracken shall file semi-annual statements detailing surcharge revenues collected, including any interest earned thereon, all expenditures made, and remaining balance. These reports shall be filed as of June 30 and December 31 of each calendar year and are due no later than 30 days subsequent to those dates. Failure to file the semi-annual reports shall warrant cessation of the surcharge and immediate refunding of the monies previously collected. If construction has not begun within 5 years after implementation of the surcharge, all funds shall be returned to West McCracken's customers, together with interest and earnings.

9. West McCracken shall maintain its records in such a manner as will enable it, the Commission, or its customers to determine the amounts to be refunded and to whom they are due in the event that surcharge amounts are ordered refunded.


10. The surcharge revenues constitute contributions and shall be accounted for in the manner prescribed in the Uniform System of Accounts for Class A and B water districts and associations. The monthly billing shall be debited to customer accounts receivable

and credited to the contributions account. When the amount is collected, special funds shall be debited and customer accounts receivable credited.

11. Within 30 days of the date of this Order, West McCracken shall file with the Commission its revised tariffs setting out the rates and surcharge approved herein.

Done at Frankfort, Kentucky, this 27th day of July, 1995.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 94-450 DATED July 27, 1995.

The following rates and charges are prescribed for the customers in the area served by West McCracken County Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Surcharge

\$.47 per 1,000 gallons for a period not to exceed 5 years.

Customer Charge

5/8 "	Meter	\$ 8.53
1"	Meter	20.93
2"	Meter	30.23
3"	Meter	51.93
4"	Meter	82.93

Water Rates

First 100,000 gallons	\$3.80 per 1,000 gallons
Over 100,000 gallons	3.24 per 1,000 gallons